Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)	CC Docket No. 98-77
	)	
Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers	)	CC Docket No. 98-166

REPLY COMMENTS OF NRTA, OPASTCO, AND USTA

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The National Rural Telecom Association (NRTA), the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), and the United States Telecom Association (USTA) (the Associations)[1] submit these joint reply comments in response to comments filed by other parties on the Further Notice of Proposed Rulemaking (FNPRM) in the above-captioned proceedings.[2]

NRTA is an association of incumbent local exchange carriers (ILECs) that obtain financing under Rural Utilities Service (RUS) and Rural Telephone Bank (RTB) programs.

[1] The Associations participated in the earlier phase of these proceedings as members of the Multi-Association Group that originally requested a comprehensive resolution of issues affecting ROR ILECs. The Commission decided the access, universal service, and ROR issues raised by the MAG group and deferred the incentive regulation and related issues for a further rulemaking proceeding. The three Associations are participating jointly in the reconsideration and further rulemaking proceeding.

[2] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 19613 (2001) (FNPRM).

OPASTCO is a trade association representing over 500 small ILECs serving rural areas of the United States. All of the members of both associations are rural telephone companies as defined in 47 U.S.C. §153(37). USTA represents more than 1,200 telecommunications companies worldwide that provide a full array of voice, data, and video services over wireline and wireless networks.

I. INTRODUCTION AND SUMMARY

The Associations urge the Commission to make incentive regulation optional for all rate-of-return (ROR) carriers and commonly-owned groups of ROR carriers on a study area-by-study area basis, and also to provide ROR carriers with immediate pricing flexibility. The record demonstrates that the diversity of carriers' service areas requires the option to adopt appropriate regulation for local conditions and that theoretical cost-shifting incentives have not materialized in actual experience and are subject to effective existing safeguards. The record also shows that competition is spreading to all areas, so that flexibility is necessary for all carriers before customers are hurt by competitive entry under market conditions distorted by pre-competitive era regulations.

The record and comments further substantiate the Commission's understanding of the wide diversity of conditions and service challenges in the study areas served by ROR ILECs. Comments that seek mandatory incentive regulation for some or all ROR ILECs fail to justify a requirement for any carrier or holding company, much less any rational basis for imposing incentive regulation on the various ROR subsets for which they demand mandatory application. The Competitive Universal Service Coalition (CUSC) (a group led by carriers obtaining support in self-selected areas that is not even based on their own costs) is simply wrong in its notion that ROR somehow guarantees revenues or an actual achieved rate of return. ROR regulation enables carriers with true carrier of last resort responsibilities to set their rates at levels designed to recover their regulated costs and a reasonable return -- unless their projections are belied by their own mistakes, regulatory changes and uncertainties, competitive growth, or other developments. Nor are quotations dredged up from the past about theoretical "gold-plating" dangers under ROR regulation persuasive now that experience has shown that incentive regulation can seriously endanger quality of service and network investment in the kind of high cost areas typically served by ROR ILECs. Moreover, the options that will best serve rural customers, while maximizing appropriate incentives for efficiency, should also enable carriers to elect incentive regulation within the National Exchange Carrier Association (NECA) pools. NECA is ready and able to implement incentive options within the pools, and commenters have shown that maintaining healthy pools is sound national policy.

AT&T, Worldcom, and the Nebraska Rural Independent Companies (NRICs) have not shown that any subset of ROR carriers has some assumed level of scale economies that warrants incentive regulation nor that any such subset actually exhibits the same variations in conditions and cost characteristics that dictate optional incentive regulation for all ROR carriers. The record compellingly demonstrates that a study area should be able to adopt incentive regulation when the actual conditions in that area support a change and when customers will benefit -- not face dried-up carrier investment or service degradation because their locality is not ready for the economic pressures of a mandatory incentive plan. Companies that have elected price caps either did so voluntarily or, in some cases, have sought relief that recognizes their different characteristics or enables them to upgrade their networks. Indeed, actual experience, regulatory developments, and the enormous changes in national policy, market conditions, and customer needs for advanced network capabilities all indicate that it is time for the Commission to repeal the outdated all-or-nothing rules. Such legal precedents and past Commission actions rested on theoretical projections that have not been realized in actuality. While valid theoretical incentives may have warranted the Commission's (and a reviewing court's) historical caution about allowing different regulation for affiliated study areas under pre-1996-Act circumstances, today's established and developing competition, portable support that invites even uneconomic entry, effective regulatory safeguards, and new competitors eager to see them enforced have dramatically altered the landscape. Current market facts fully justify removal of the all-or-nothing rules.

The record in this proceeding also provides compelling evidence that immediate pricing flexibility is essential, so that ROR carriers may adequately respond to the increasing threat and presence of competition within their respective rural service areas. As ALLTEL, *et al* note, new technologies have allowed an increasing array of competing carriers -- including wireless carriers, cable television systems, and satellite operators -- to begin offering services in direct competition with ROR ILECs. Therefore, the provision of pricing flexibility to ROR carriers should not be preconditioned on a system of restrictive and unworkable competitive triggers. Should ROR carriers be forced to lose the few high-volume customers in their rural service areas, prior to obtaining pricing flexibility, residential subscribers may be subject to significant rate increases in order to compensate for the lost revenue. A number of other commenters also dispute the necessity for competitive triggers, noting that it is quite unlikely that pricing flexibility could be manipulated by ROR ILECs so as to obstruct competition. Finally, there is no reason why ROR carriers should have to leave the pools in order to obtain pricing flexibility, as NECA has indicated that it can make the necessary accommodations.

II. THERE IS NO JUSTIFICATION IN THE RECORD FOR PROPOSALS TO MANDATE INCENTIVE REGULATION FOR *ANY*, LET ALONE *ALL*, ILECs OR HOLDING COMPANIES

Most comments recognize the enormous variations among ROR ILECs and the consequent error of any mandatory "one size fits all" incentive plan (*see, e.g.*, NTCA, pp. 2-4;

ALLTEL, *et al*, pp. 3-6; Western Alliance pp. 3-10; and GCI, p. 83). Nevertheless, some commenters (CUSC, p. 2; Sprint, p.4) advocate a mandatory incentive plan for all ROR ILECs. Others would carve out some subset of ROR carriers or their parent companies, although there is no agreement as to what subset. None of the proponents of mandatory incentive regulation justifies either the proposal to require conversion or the carriers it seeks to encumber with a mandatory incentive plan.

CUSC, a group formed by wireless carriers, claims (pp. 3-5) that ROR regulation must be terminated for all carriers after a very short transition as a "form of regulation that relies on ensuring a carrier's rate of return" and, according to CUSC, "a revenue guarantee." Based on its perception of the nature of ROR regulation, CUSC claims (p. 3) that ROR is at odds with efficiency and competition. CUSC's rationale for abolishing ROR regulation, regardless of a carrier's circumstances, reflects a fundamentally mistaken view of ROR regulation and conflicts with the Commission's current understanding of the effects of incentive regulation, now based on extensive experience with price caps and CALLS regulation of the largest carriers.

First, CUSC is simply wrong that ROR regulation "guarantees" a carrier either a specified return or specified revenues. ROR regulation merely allows a carrier to target its rates to earn the authorized rate of return. The authorized rate of return is not a minimum on what the carrier may lawfully earn, much less a revenue guarantee.[3] ROR carriers may lawfully target their rates in any given period to recover their costs plus the authorized rate of return. But if their forecasts are wrong in a year or competition takes traffic on which they had relied in setting their rates, they can earn less than the authorized ROR for that year. Under those circumstances, ROR regulation only provides the opportunity to set more accurate target rates for the following

[3] *MCI Telecommunications Corp. v. Federal Communications Commission*, 59 F.3d 1407, 1419 (D.C. Cir. 1995), *cert. denied*, 517 U.S. 1240, 116 S. Ct. 1890 (1996).

tariff period. ROR regulation does not guarantee earnings or revenues and is not inconsistent with competition or efficient operations.

Second, CUSC makes much of Commission statements in 1995, which it quotes in its comments (p. 4), about price caps regulation as a means of preventing "needless gold plating" and fostering positive investment incentives and innovation. However, the Commission has, since then, recognized that incentive regulation can both discourage desirable investment and reduce the quality of service if it is not carefully designed and applied and has backed away from unsubstantiated theoretical charges of gold-plating.[4] CUSC, however, has missed the point that an optional plan is necessary to allow flexibility for carriers to move to incentive regulation when it is consistent with maintaining their service quality and when it will encourage healthy infrastructure investment, without forcing carriers into a plan that will have the opposite effects.

Sprint (p. 4) calls for a mandatory incentive plan for all ROR ILECs to prevent self-selection.[5] Consequently, Sprint would impose a single productivity factor, in spite of the proven diversity of ROR carriers. To make matters worse, Sprint would have the Commission grant relief only after-the-fact and only after a rural ILEC demonstrates that incentive regulation has already reduced its access charges below forward-looking economic costs (FLEC). Thus, in sharp contrast to the Commission's wise recognition of the diversity and individualized service challenges of ROR carriers,[6] Sprint seeks a particularly harsh standard for these ILECs. Indeed,

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[4] See, e. g., FNPRM, ¶¶220, 224 (need to ensure that incentive regulation will not dampen investment and service quality); *Implementation of Section 402(b)(2)(A) of the Telecommunications Act of 1996; Petition for Forbearance of the Independent Telephone & Telecommunications Alliance*, 14 FCC Rcd 11364, 16 CR 529, 1999 FCC LEXIS 3037 (June 30, 1999) ("[O]ur experience in reviewing section 214 entry applications received in recent years leads us to conclude that virtually no carriers, rate-of-return carriers or others, are in fact attempting to "gold-plate" their networks at the expense of consumers"). Even in establishing incentive regulation, the Commission realized the need "to observe the success of incentive regulation and to become aware of any reduction of service quality or infrastructure investment." Revision of Filing Requirements, 11 FCC Rcd 14110, 5 CR 2025, 61 FR 10522 (February 27, 1996).

[5] AT&T is also concerned about self-selection if a plan is optional, but apparently only for holding companies that exceed some arbitrary cumulative line level.

[6] FNPRM, ¶ ¶ 4, 227.

whereas Sprint would require ROR ILECs to adhere to FLEC costing to show that incentive regulation was not consistent with maintaining sound investment and service quality, the Commission's decision not to prescribe FLEC for access charges -- even for the huge price cap ILECs -- has passed judicial muster and remains in effect today.[7]

Worldcom (p. 2), AT&T (p. 2*,* p. 14), and the NRICs (pp. 4-5) advocate mandatory incentive regulation for commonly-owned ILECs serving, in the aggregate, 200,000, 50,000, and 100,000 lines.[8] AT&T and the NRICs simply assert that a group with the arbitrary number of lines selected in each case has the "scale," "buying power," or predictable investment patterns to realize productivity gains. None provides data to support its own conclusory assertions that sufficient scale economies are available when a particular number of lines are under common ownership, let alone an explanation of why that is not the case at other line levels or what link relates these characteristics to common ownership. None explains why the established link between scale economies and population *density* is not the controlling factor for holding companies with scattered, low-density study areas. Indeed, none of the comments even establishes that there is a link between aggregate line size and productivity in the first place.

AT&T and Worldcom speculate that ROR holding companies of some arbitrary line size can operate under price cap regulation, based on the supposedly successful experiences of Valor, Iowa Telecom, Citizens, and Frontier. There are many differences between these companies and companies that have not elected price cap regulation. Valor and Iowa Telecom, for example, chose price caps regulation when the only alternative was to perform FLEC cost studies, not

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7 *See, Southwestern Bell v. FCC*, 153 F3d 523 (8th Cir 1998). The Commission again put off its "eventual" prescription of FLEC-based rates for the price cap companies in adopting the CALLS plan. *Access Charge Reform Price Cap Performance Review For Local Exchange Carriers Low-Volume Long-Distance Users Federal-State Joint Board On Universal Service,* 15 FCC Rcd 12962, ¶60 (2000).

8 AT&T's resubmitted comments seem to delete the 50,000 lines benchmark from the description of a proposed plan, but assert that "carriers" with more than 50,000 lines have the scale to operate under price caps regulation. Although AT&T uses the terms "carriers" and "LECs" in connection with the 50,000 benchmark, its discussion on p. 14 indicates that it means holding companies with this cumulative level of lines.

because it was better for their customers than ROR regulation. Moreover, the comments ignore (1) that Iowa Telecom is currently seeking relief from the excessive burdens of the CALLS regime because it cannot invest in necessary network improvements and (2) that Citizens has tried unsuccessfully to obtain Commission recognition for the burdens it perceives in using price cap regulation for its rural operations.[9] In any event, if ROR LECs were as similar to the listed price cap LECs as the arguments assume, and could operate successfully and serve their customers well under price cap regulation, the commenters have failed to explain why the carriers did not elect price caps in the past.

The presumption that holding companies above a certain level of aggregate access lines can sustain price cap or other incentive regulation also flies in the face of the Commission's analysis of ALLTEL and its acquisition of Aliant.[10] Rather than enforcing the rule that all of ALLTEL's subsidiaries would have to join Aliant as price cap companies, the Commission first allowed Aliant to return to ROR regulation. The Commission explained that, even with Aliant's 285,000 lines, bringing ALLTEL to over 2 million access lines -- together with an earlier acquisition of more and denser lines in Georgia for which a waiver had also been granted --

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[9] *See*, *Access Charge Reform / Price Cap Performance Review For Local Exchange Carriers / Transport Rate Structure And Pricing / End User Common Line Charges,* 12 FCC Rcd 15982, ¶333 (1997):

> We do not agree that Citizens Utilities should be exempt from some of the rules we adopt in this order for price cap companies …. Although Citizens Utilities arguably may face different circumstances than other price cap LECs that serve larger urban and suburban populations, Citizens has indicated, by electing price cap regulation, that it believes it can achieve a higher rate of productivity than smaller rate-of-return LECs and that price cap regulation is more beneficial to it than rate-of-return regulation. Citizens Utilities has not demonstrated that the modifications we are adopting in this proceeding would necessarily affect it differently than other price cap LECs. If Citizens Utilities believes that it cannot remain financially viable as a price cap carrier under the revised access charge regime, it may petition for a waiver of the rule that makes its decision to elect price cap regulation irreversible (footnote omitted).

[10] *ALLTEL Corporation; Petition for Waiver of Section 61.41 of the Commission's Rules and Applications for Transfer of Control,* 14 FCC Rcd 14191 (September 3, 1999).

ALLTEL remains much smaller than the mandatory price cap companies.[11] Moreover, said the Commission:

> Price cap regulation for the entire operations of the merged companies would include the application of a single productivity factor. ALLTEL believes that this would not be suitable for its entire operation at this time. We agree. As ALLTEL points out, it serves dispersed geographic areas in 22 states and consequently, faces varied market conditions. Therefore, the types of efficiencies that may be sustainable for the Regional Bell Operating Companies and GTE in the long run may not be sustainable in many of the ALLTEL LEC study areas.

Since then, Aliant has been allowed to remain under price cap regulation, while the rest of ALLTEL is under ROR regulation, because the public interest is better served by not forcing Aliant back to ROR regulation.[12] No cost shifting abuses have occurred.

In short, the Commission has already determined that across-the-board price cap regulation is *not* appropriate for all parts of even the largest holding company to which parties now seek to extend mandatory price cap regulation. Beyond that, the Commission lacks any factual basis for determining that any ROR ILEC or holding company over any arbitrary line size can achieve productivity gains, maintain high quality service, and invest in its network under mandatory incentive regulation. It is clear that it cannot just pick an arbitrary number from a range of guesses by a few parties.[13] In contrast, the record on the diversity of ROR ILECs and the varying, often difficult, conditions under which they provide service is compelling. The Commission must, accordingly, reject proposals to make incentive regulation mandatory for any ROR carrier or group of carriers under common ownership.

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[11] *Id.,* ¶26.

[12] *ALLTEL Corporation Petition for Waiver of Section 61.41 of the Commission's Rules*, Order, DA 01-1408, CCB/CPD No. 99-01 (Common Carrier Bureau, rel. June 12, 2001); *ALLTEL Corporation Petition for Waiver of Section 61.41 of the Commission's Rules*, CCB/CPD No. 99-01, Order, 15 FCC Rcd 23227 (2000).

[13] *See Texas Office Of Public Utility Counsel, et al. v. FCC*, 265 F3d 313 (5th Cir. 2001).

III. SPECULATIVE RISK ASSESSMENTS MADE TEN OR MORE YEARS AGO ABOUT COST-SHIFTING FROM LETTING EACH AFFILIATED ILEC STUDY AREA CHOOSE THE REGULATORY REGIME APPROPRIATE FOR ITS CIRCUMSTANCES HAVE BEEN OBVIATED BY THE 1996 ACT, ADDED REGULATORY SAFEGUARDS AND ACTUAL EXPERIENCE

There is strong support in the comments (ALLTEL, *et al*, pp. 23-33; ITTA, pp. 2-6; the Associations, pp. 8-12) for abandoning the Commission's requirements that all ILECs under common ownership, other than average schedule ILECs, must be under the same form of regulation and that all commonly-owned ILECs must generally have the same common line pooling status. Parties that support retaining the all-or-nothing rules rely on supposed legal precedent, justifications from a decade ago, and unsupported assumptions about current conditions. None of their arguments justifies retention of the rules in the current environment.

AT&T (pp. 15-19) builds its argument from legal precedent on a statement by the court in *NRTA v. FCC,* 988 F 2d 174, 179-80 (D.C. Cir. (1993) that:

> it seems quite obvious that dual regulation … has a key feature in common with regulated-unregulated dual status: a firm can escape the burden of costs incurred in its unregulated or price cap business by shifting them to the rate-of-return affiliate, which can then pass them on to ratepayers.[14]

While AT&T seems to think this is a judicial endorsement of the merit of the all-or-nothing rules, the case before the court (and consequently its decision) was far narrower than AT&T assumes. Indeed, the issue there was the operation of three rules "developed to govern the relation between price cap regulation and companies' mergers and acquisitions." The court held that the Commission had reasonably weighed the risks that mergers and acquisitions would undermine price cap cost incentives against the value of such transactions and had provided for waiver when the balance cut the other way.

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[14] AT&T at 15, quoting *NRTA v. FCC* at 179-80.

The court viewed incentives for cost-shifting in connection with mergers between entities under price cap and ROR regulation as "a variation on the sort of cost shifting between an enterprise's regulated and unregulated affiliates that is a concern under rate-of-return regulation generally." Although the challengers had questioned whether cost shifting was a valid concern in the circumstances, the court observed that those parties had "explicitly recognize[d] the historic [cost shifting] concern in the context of regulated and unregulated affiliates," challenging only its extension "to the context of price cap and rate-of-return affiliates." Thus, because to the court it was "quite obvious" that the "cost-shifting" concern was the same in both "contexts," the court upheld the Commission's concern about cost-shifting.

However, the court did not hold that all-or-nothing rules were the only or even the best way to deal with cost shifting. It simply held that the parties had not shown that the Commission's choice not to rely on less drastic safeguards in that context was inconsistent with the balance struck in other cost-shifting contexts, where, given "the conditions prevailing in the relevant markets, the efficiencies to be secured by replacing structural with non-structural barriers outweighed the risks." *NRTA v. FCC* does not control the proper result now and under today's circumstances -- which is to repeal the all or nothing rules across-the-board -- because the "conditions prevailing in the relevant markets" and the balance of efficiencies under the rule have changed drastically since a decade ago when the rules were adopted and the D.C. Circuit upheld the balance struck then by the Commission.

Since adoption of the all-or-nothing rules and the decision in *NRTA v. FCC*, the Commission has seen successful implementation and operation of safeguards to prevent and detect potential cost-shifting. Safeguards now deal admirably with regulated and unregulated portions of ILECs' businesses, the paradigm for cost-shifting from which the *NRTA v. FCC* court drew justification for the Commission's cost-shifting concerns in the price caps/rate-of-return context. The Commission and the states no longer express concerns about cost shifting when carriers are under ROR regulation at the interstate level and alternative regulation plans for intrastate service or vice versa. Experience has taught that theoretical cost-shifting incentives are simply not demonstrated in companies' actual behavior as demonstrated by the price caps and ROR regulation situations that have occurred under Commission waivers.

CUSC (pp. 5-6) urges retention and inflexible application, with no waivers, of the all-or-nothing rules solely on the basis of its unsupported and unexplained contention that the rules prevent ILECs from anti-competitive and anti-consumer "gaming [of] the system" that would otherwise imperil competition in rural areas. Worldcom, with a similar lack of facts or explanations, asserts that cost shifting will not be constrained because of what it characterizes as relaxed oversight of ROR carriers' accounting practices, absence of competition, and unspecified market structure characteristics. AT&T asserts (p. 16) that LECs have the incentive and the ability to shift costs and profits among subsidiaries under price cap and ROR regulation, to jump to and from one form of regulation to another, and to lower the costs of affiliates faced with competition. Again, AT&T provides no facts or examples, relying solely on the Commission's allusions in the 1990 LEC Price Cap Order (¶ 272) to record evidence that "holding companies have both the means and the motive" for such shifting. Curiously, that Commission statement has never been supported with specifics, and AT&T does not supply them now. In any event, the quoted statement does not even claim that the "means" and "motive" led to explicit cost-shifting behavior, even back in the period before the 1990 Order.

Even more important, all champions of the all-or-nothing rule brush aside the sea change in the law effectuated when the 1996 Act adopted competition as national policy. Indeed, CUSC's complaint that letting study areas elect suitable regulation would be anti-competitive is ludicrous coming from a group whose members are receiving "portable" federal universal service support to enter the nation's most rural areas. The rural entry business plans and existing rural operations of Western Wireless, for example, make a mockery of AT&T's assumption that markets still exist where ILECs can safely shift and recover costs while they reduce the costs for more "competitive" areas. Open competitive entry, portable support, actual rural competitors, an Act that encourages deregulation and market reliance -- all new since the adoption and judicial review of the price caps all-or-nothing rule -- combined with time-tested, effective safeguards provide compelling reasons for the Commission to abandon a rule developed for another regulatory era.[15]

Thus, the record is bare of persuasive arguments, let alone factual evidence, that it is necessary or beneficial to force all commonly-owned ILECs into the same regulatory mold. Accordingly, the Commission should repeal the all-or-nothing rule and allow each study area to elect the most appropriate form of regulation for the local conditions.

Furthermore, the Associations concur with NTCA (p. 4), which explains why the Commission should allow NECA to revise its pooling procedures to accommodate incentive regulation. As NTCA points out, the maintenance of healthy NECA pools has "created incentives and spread risks in a way that has not only enhanced telephone service, but also helped bring substantial economic value to … rural communities." NECA (pp. 6-9) has indicated that it can readily adapt the pooling process to accommodate optional incentive

[15] The Commission should not credit AT&T's proclamation (p. 18) that ILEC study areas are not prevented from choosing appropriate regulation and claim (p. 19) that waivers of the all-or-nothing rules allowing continued ROR regulation have "cost consumers millions of dollars in lost access charge reductions." In the first place, the diversity among ROR carriers and study areas prevents a single plan that will be appropriate for all, regardless of common ownership. Investment and pricing decisions for individual carriers and study areas under common ownership are essential in the competitive environment. Second, the Commission no longer holds the simplistic belief attributed to it by AT&T (p. 18) that incentive regulation is invariably superior to ROR regulation, now that it has seen that inappropriate incentive regulation can threaten service quality and stifle investment in less profitable markets under common ownership. And, finally, there is no reason to believe that higher access charges are not wholly cost-based for ROR companies, or, for that matter, that AT&T would have passed any savings from lower access charges through to long distance consumers anyway.

regulation. Therefore, there is no reason for the Commission to require ROR ILECs to leave the pools in order to exercise this choice, and it should reject AT&T's proposal to do so.

IV. THERE IS AMPLE SUPPORT IN THE RECORD FOR THE COMMISSION TO IMMEDIATELY GRANT PRICING FLEXIBILITY TO ROR ILECS, SO THAT CONSUMERS MAY BENEFIT FROM A SUSTAINABLE COMPETITIVE MARKETPLACE

In its initial comments (pp. 17-21), the Associations wholeheartedly endorsed the Commission's belief that it is important for ROR ILECs to have pricing flexibility so that they may adequately respond to competition within their respective service areas.[16] Numerous commenters (ALLTEL, *et al*, pp. 46-50; ICORE, p. 16; ITTA, pp. 7-10; NTCA, pp. 8-10; Sprint, pp. 5-6; TCA, pp. 3-6) agree that, as competition within the telecommunications marketplace has evolved, additional pricing flexibility has become necessary for ROR ILECs.

The empty assertions made by commenters such as AT&T (p. 20), CUSC (p. 7), and Worldcom (p. 4) that ILECs do not require pricing flexibility, due to the lack of competitive entry in their service areas, are incorrect and disproven by the record. A number of commenters (ALLTEL, *et al*, pp. 12-19; ICORE, p. 16; ITTA, p. 7, 9; TCA, p. 5) indicate that the increasing presence of competition within rural service areas makes immediate pricing flexibility a fundamental necessity for ROR carriers. ALLTEL, *et al* (pp. 13-14) correctly note that, as both legal and regulatory barriers to competitive entry have fallen, competition has advanced substantially in rural America. Indeed, ITTA (p. 7) states that several of its members currently operate in some of the most competitive service areas in the United States.

Several commenters (ALLTEL, *et al*, pp. 12-19; ICORE, p. 16; ITTA, pp. 7-8; TCA, pp. 3-5) provide ample evidence of the wide array of competitors that are now confronting rural ROR ILECs. New technologies have allowed an increasing number of competing carriers to see

[16] FNPRM, ¶247.

profit potential in rural areas, and therefore include them in their service plans. ALLTEL, *et al* (p. 14-15) point out that the competition is not limited to competitive local exchange carriers (CLECs) alone. In fact, a variety of wireless carriers, cable television operators, and satellite broadband providers all presently offer services in rural areas -- in direct competition with ROR ILEC services.

The Associations agree with those commenters (ALLTEL, *et al,* pp. 17-18; TCA, pp. 5-6) who indicate that, as wireless telecommunications technology has advanced, it has become a viable alternative to traditional wireline service for an increasing number of Americans, including those living in rural areas. Indeed, ALLTEL, *et al* (p. 17) point out that the Commission's own Sixth Annual CMRS Report found that, "[i]n some areas, wireless use has begun to erode wireline revenue due to 'technology substitution' -- that is, the substitution of new technologies for existing ones."[17] Furthermore, since wireless carriers are aggressively expanding their respective local calling scopes and/or offering service plans that do not charge extra for toll calls, this revenue erosion will become more pronounced.[18] Such service offerings are likely to encourage an even greater number of end users to use a wireless carrier as their primary provider of voice service.[19] The Commission itself has stated that "[f]or some, wireless service is no longer a complement to wireline service but has become the preferred method of communication."[20] This view is consistent with a study noted by the Associations (p. 18), which predicted that a significant number of Americans will no longer subscribe to wireline phone service several years from now.

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[17] *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, Sixth Report, FCC 01-192 (rel. June 20, 2001) (Sixth Annual CMRS Report) at 32.

[18] TCA at 5. *See also*, Sixth Annual CMRS Report at 33 (footnote omitted).

[19] *See*, ALLTEL, et al at 20-21, fns. 55, 57.

[20] *See, Sixth Annual CMRS Report* at 32. *See also,* ALLTEL, *et al* at 17, fn. 47.

Moreover, in recent years both state public utility commissions and the FCC have granted a number of wireless carriers eligible telecommunications carrier (ETC) status in rural service areas.[21] As the Associations (p. 18, fn. 35) note, Western Wireless currently has ETC status in 13 states. Additionally, ALLTEL, *et al* (p. 18) points out that other wireless operators -- such as Sprint PCS in California and Arkansas, and the United States Cellular Corporation in Washington -- have also become eligible for universal service funds.[22] Wireless competitors such as these are simply not fragile, financially disadvantaged new entrants. To the contrary, these carriers are often larger in scale and in possession of far greater financial resources than the rural ILECs they compete against.[23]

In addition to wireless carriers, rural markets have also proven increasingly attractive for other types of competitors. For instance, ALLTEL, *et al* (pp. 14-16, 18-19) address the growing competition from cable system operators and satellite providers. ALLTEL, *et al* (p. 16) also notes that, in spite of recent financial turbulence in the CLEC industry, independent researchers have compiled data on over 200 facilities-based CLECs across the country. In light of the wide diversity of competitors described in the record for this proceeding, it has been clearly demonstrated that the threat of competition is present in rural America.

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[21] *See,* ALLTEL, *et al* at 17-18, TCA at 5. Additionally, ITTA correctly points out that wireless carriers who are granted ETC status also benefit from regulatory arbitrage, since current Commission rules permit them to "[collect] universal service support based on ILECs costs." ITTA at 9. Moreover, these carriers can choose where to request ETC status in order to maximize their profit from such arbitrage.

[22] Additionally, the most recent Universal Service Administrative Company (USAC) Quarterly Administrative Filing also lists the following wireless carriers as having ETC status: CELLCO Partnership d/b/a Bell Atlantic Mobile in Delaware, Guam Cellular and Paging in Guam, RFB Cellular, Inc. in Michigan, and Centennial Communications in Puerto Rico. *See,* Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections and Contribution Base for the Second Quarter 2002*, Appendix LI2, available at USAC website (http://www.universalservice.org/overview/filings/2002q2).

[23] During fiscal year 2001, Western Wireless collected just over $1 billion in revenue, and had operating income of nearly $20 million. During the same fiscal year, Sprint PCS Group collected net operating revenues of $9.7 billion, while U.S. Cellular reported $1.9 billion in total revenue. *See,* Western Wireless Corporation, Sprint Corporation, and U.S. Cellular Corporation, Fiscal Year 2001 Earnings Releases, published on February 26, 2002 (Western), February 4, 2002 (Sprint), and January 29, 2002 (U.S. Cellular). These financial results are well in excess of most independently owned rural telephone companies.

A number of commenters (NTCA, p. 9; TCA, p. 4) agree with the Associations that pricing flexibility for ROR ILECs should not be conditioned on the existence of some level of competition. In order to effectively compete against new entrants, who often bring greater resources to bear than the incumbent, ROR ILECs need the immediate ability to employ all forms of pricing flexibility. NTCA (p. 9) correctly explains that because "[r]ural carriers are often reliant on a few large users for the bulk of their revenues," the loss of these customers "may cause the rest of a community's end-user rates to skyrocket to unaffordable levels." Thus, as ITTA (p. 10) states, "even an apparently low level of competition … may represent a significant competitive threat to such a rural ILEC."

The adoption of immediate pricing flexibility would permit ROR carriers to respond to these threats. Geographic rate deaveraging, volume and term discounts, and contract pricing would provide ROR carriers with the flexibility to tailor services and rates to individual customer demands,[24] just as their competitors are free to do. Pricing flexibility would also make individual ROR carriers' pricing structures more efficient, as noted by the Commission.[25]

Contrary to the claims of some commenters (AT&T, pp. 21-22; GCI, p. 12), NECA (pp. 9-10) has indicated that the pooling process can accommodate pricing flexibility. Rate banding, as presently defined, permits NECA to establish differing rates for the same access rate elements within the pooling process.[26] NECA also states that it could modify its settlement and rate setting mechanisms on a targeted basis to narrower groups of companies without undue hardship. Thus, the Commission should allow NECA to develop the necessary administrative

[24] *See,* ALLTEL, *et al* at 47, ITTA at 8-9, TCA at 4.

[25] FNPRM, ¶249. *See also,* ALLTEL, *et al* at 47.

[26] NECA at 9.

procedures to allow carriers to obtain pricing flexibility within the pooling environment. This is essential to the sustainability of the pools themselves.[27]

Commenters (ALLTEL, *et al*, p. 48; ITTA, p. 8) agree with the Commission and the Associations[28] that the competitive triggers that have been adopted for price cap carriers would be too restrictive for ROR carriers. Others (NTCA, pp. 9-10; TCA, pp. 4-5) point out the difficulty the Commission would encounter in devising competitive triggers that would not withhold pricing flexibility until a competitive entrant has seriously undermined the ROR ILEC's continued viability as the carrier of last resort. NTCA (p. 10) asserts that, "[c]ompetitors may enter a rural ILEC service territory and capture a large volume user without ever triggering any of these [proposed] requirements." As an example, ALLTEL, *et al* (p. 48) notes that one of the proposed competitive triggers -- collocation -- is not always an accurate measure of rural competition. ALLTEL, *et al* (p. 48), ITTA (p. 9), and TCA (p. 5) all indicate that wireless ETC competitors do not collocate at ILEC central offices, and thus, could compete with ROR ILECs without "setting off" a trigger that would initiate pricing flexibility for the ILEC.

Beyond the inherent difficulty in creating workable competitive triggers for ROR carriers, there is no evidence that triggers are even necessary to prevent, "pricing flexibility [from being] used to erect a barrier to competitive entry."[29] Several commenters (NTCA, p. 10; Sprint, pp. 5-6; TCA, pp.4-5) question the degree to which ROR carriers could actually use pricing flexibility to obstruct competition. As NTCA (p. 10) reminds the Commission, "[r]ate of return carriers are rate regulated and there exist current accounting procedures and regulatory structures to prevent abuse." Even Sprint (pp. 5-6) states that, "[a]ssuming that the rates established pursuant to any pricing flexibility mechanism are cost-based (as they are supposed to

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[27] *See,* the Associations at 19-20.

[28] FNPRM, ¶257, the Associations at 20-21.

[29] FNPRM, ¶250.

be), the likelihood that 'pricing flexibility might be used to erect a barrier to competitive entry' is minimal."

Lastly, ITTA (p. 9) concurs with the Associations that, should the Commission be compelled to create a series of competitive "triggers," they should be activated by the entry of more than just wireline competition. As ITTA notes (p. 9), a wireless carrier "could deploy a single tower near a large office park located in a predominantly rural area and offer the tenants there volume discounted services at prices far below what they are currently paying their ILEC," without the ILEC being able to effectively respond. Thus, in order to be technologically neutral, ROR ILECs should become eligible for pricing flexibility upon the entry of any competitor, regardless of the technology employed.

V. CONCLUSION

As explained in the Associations' opening comments and foregoing reply comments, the record establishes that it is time for the Commission to acknowledge the major changes in national policy, unintended regulatory impacts as regulations outlive their need and justifications, and the relentless pressures of existing and developing competition, *without forgetting* the hard-won successes of ROR regulation in serving extremely diverse high-cost areas and customers. Accordingly, the Associations urge the Commission to make any incentive regulation plan optional for all ROR carriers, to repeal the all-or-nothing rules to let carriers tailor regulation to the conditions and "readiness" of particular local markets, and to immediately provide pricing flexibility for ROR carriers to deaverage access charges geographically, provide term and volume discounts, and enter into contracts.

Pricing flexibility is essential *before* the economic underpinnings for good, area-wide service in ROR carriers' markets are undermined by competition that the incumbent is not free to meet fairly.

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CERTIFICATE OF SERVICE

I, Alicia C. Reid, hereby certify that a copy of the joint reply comments by the National Rural Telecom Association, the Organization for the Promotion and Advancement of Small Telecommunications Companies, and the United States Telecom Association was sent on this, the 18th day of March, 2002 by first class United States mail, postage prepaid, to those listed on the attached sheet.

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